

Message Text

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ORIGIN TRSE-00

INFO OCT-01 EUR-25 ISO-00 AID-20 CIAE-00 COME-00 EB-11

FRB-03 INR-11 NSAE-00 RSC-01 XMB-07 OPIC-12 SP-03

CIEP-03 LAB-06 SIL-01 OMB-01 SS-20 NSC-07 L-03 H-03

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DRAFTED BY TREAS:RVKORP/FLWIDMAN:DS

APPROVED BY EB/IFD-SWEINTRAUB

TREAS:CCOOPER(DRAFT)

TREAS:PHOGAN(DRAFT)

FEDERAL RESERVE:PWONNACOTT(DRAFT)

EB/IFD/OMA:RRYAN

EB/IFD/OMA:GPBALABANIS

EUR/NE:CFLOYD(INFO)

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TAGS: EFIN

PASS UNDER SECRETARY BENNETT FROM COOPER

SUBJECT: DRAFT TALKING POINTS

1. DIFFICULTIES IN RECENT WEEKS OF A FEW BANKS
HEAVILY INVOLVED IN INTERNATIONAL TRANSACTIONS HAVE
CONTRIBUTED TO CONCERN EXPRESSED BY A NUMBER OF
OBSERVERS -- BOTH IN THE PRIVATE BANKING COMMUNITY AND IN
OFFICIAL QUARTERS -- AS TO THE ABILITY OF PRIVATE FINANCIAL
MARKETS TO HANDLE FLOWS OF FUNDS ARISING FROM OIL PRODUCING
COUNTRY SURPLUSES. THE PROBLEMS OF INDIVIDUAL BANKS HAVE
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BEEN THE RESULT OF IMPRUDENCE OR OTHER MANAGEMENT PROBLEMS
PARTICULAR TO THE FIRMS. THEY DO NOT IMPLY AN IMPENDING GENERAL
FAILURE OF FINANCIAL MARKETS OR THE MONETARY SYSTEM. WE ALL
RECOGNIZE THAT THE MARKETS FACE A SERIOUS CHALLENGE BUT WE

SHOULD BE CAREFUL NOT TO EXAGGERATE OR OVERSTATE THE DIFFICULTY.

2. MARKETS HAVE MADE A GREAT CONTRIBUTION TOWARDS SOLVING PROBLEMS OF WORLD FINANCE EMERGING FROM OIL PAYMENTS. MARKETS ARE CLEARLY GOING THROUGH PERIOD OF RAPID CHANGE, FACING NEW SITUATIONS AND NEW PROBLEMS. BANKS ARE BEING OFFERED UNPRECEDENTED AMOUNTS OF MONEY BY VERY SMALL NUMBER OF DEPOSITORS AND AT SHORT TERM. IT IS NOT SURPRISING THAT OIL PRODUCERS HAVE SOUGHT TO PLACE THEIR MONEY IN SHORT TERM INSTRUMENTS, AS AN INITIAL REACTION TO THEIR NEW WEALTH. VERY HIGH SHORT TERM RATES HAVE PROBABLY CONTRIBUTED TO THIS TENDENCY.

3. THAT SITUATION PRESENTS PROBLEMS FOR BANKS: VERY LARGE LIABILITIES RELATIVE TO THEIR CAPITAL BASE; TOO MUCH CONCENTRATION ON PARTICULAR LENDERS; EXCESSIVE DIVERGENCE IN MATURITY PREFERENCES OR LENDERS AND BORROWS; INDIVIDUAL BORROWERS OR BORROWING COUNTRIES RUNNING UP LIABILITIES IN AMOUNTS SO LARGE AS TO RAISE THE RED FLAG IN TERMS OF TRADITIONAL BANK PRACTICES.

4. EMERGENCE OF THESE PROBLEMS CAUSES BANKERS TO WORRY AND EXPRESS THEIR WORRIES PUBLICLY. AT THE SAME TIME, HOWEVER, BANKERS HAVE BEEN BUSY ADAPTING AND INNOVATING AND TAKING STEPS TO DEAL WITH THESE PROBLEMS.

5. THIS IS ENCOURAGING. THIS IS THE WAY IT OUGHT TO BE. WE ARE SEEING DIFFERENTIATION IN TREATMENT OF LENDERS AS WELL AS BORROWERS. WE ARE SEEING REDUCED INTEREST RATE OFFERS FOR LARGE SHORT TERM DEPOSITS; WE ARE SEEING BANKS ACTING AS BROKERS, ARRANGING DIRECT PLACEMENTS.

6. THE LENDERS ARE GETTING THE MESSAGE. THEY ARE LOOKING FOR OTHER PLACES TO PUT MONEY AND OTHER WAYS OF PLACING IT: GOVERNMENT SECURITIES (U.S. GOVERNMENT BUT PROBABLY OTHER GOVERNMENTS ALSO); ADVANCE PAYMENTS FOR IMPORTS; PHASED LOANS TO GOVERNMENTS; CREDITS TO NATIONALIZED INDUSTRIES AND CORPORATE BORROWERS; REAL ESTATE, AND BUYING INTO BIG CORPORATE LIMITED OFFICIAL USE
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TIONS. ALL THESE THINGS ARE HAPPENING IN INCREASING VOLUME AS THE BANKS ANNOUNCE THEIR LIMITATIONS.

7. OUR JOB IS TO KEEP WATCHING SITUATION CLOSELY BUT CALMLY AND TO CONTINUE TO LOOK FOR NEW TECHNIQUES, NEW CHANNELS OF MOVING FUNDS TO THOSE WHO NEED THEM. SOME OF THE TRADITIONAL PRACTICES MAY HAVE TO BE REEXAMINED. MANAGEMENT MUST BE PRUDENT AND CAREFUL. BUT THERE IS NO REASON WHY THE BANKING SYSTEM CANNOT CONTINUE TO HANDLE A LARGE PERCENTAGE OF THESE FUNDS WHILE THE REST FLOW THROUGH OTHER CHANNELS,

8. GOVERNMENTS AND CENTRAL BANKS THROUGH THEIR SUPERVISORY FUNCTIONS AND IN THEIR ROLE AS SUPPLIERS OF LIQUIDITY TO THE SYSTEM ARE NOT PREPARED AND SHOULD NOT BE CALLED UPON TO UNDERWRITE MISMANAGEMENT IN PARTICULAR INSTITUTIONS OR TO ASSUME RISKS FOR PARTICULAR STOCKHOLDERS. HOWEVER, GOVERNMENTS AND CENTRAL BANKS ARE QUITE AWARE OF THEIR RESPONSIBILITIES TO ASSURE THE SOUNDNESS OF THE SYSTEM AS A WHOLE AND TO THE PRESERVATION OF A FUNCTIONING MARKET. GOVERNMENTS ALSO HAVE RESPONSIBILITY TO MAINTAIN A PROPER ENVIRONMENT BY AVOIDING INFLATION AND FOLLOWING SUITABLE OVERALL ECONOMIC POLICIES.

9. PUBLIC AUTHORITIES WILL ALSO HELP OUT IN ARRANGING OTHER CHANNELS FOR FINANCING OIL DEFICITS. AN URGENT TASK IS TO ENSURE THAT COUNTRIES MOST SEVERELY AFFECTED BY THE OIL PRICE INCREASES ARE ABLE TO OBTAIN THE FUNDS THEY NEED AND GOVERNMENTS ARE AWARE OF THIS PROBLEM. WE HOPE THAT A NEW DEVELOPMENT COUNCIL -- THE JOINT INTERMINISTERIAL COMMITTEE RECENTLY SUGGESTED BY THE C-20 -- CAN TAKE ON THIS PROBLEM AND HELP GET THE JOB DONE. IN ADDITION, THE IMF HAS UNDERTAKEN TO ESTABLISH A SPECIAL OIL FACILITY TO SERVE AS KIND OF "SAFETY NET" FOR OTHER COUNTRIES UNABLE TO BORROW THROUGH THE PRIVATE MARKETS.

10. AS THE VOLUME OF FUNDS TO BE PLACED AND TO BE BORROWED BUILDS UP, THE OIL PRODUCING COUNTRIES THEMSELVES ARE BEGINNING TO RESPOND AND TO PROVIDE DIRECT LOANS OR OTHER TYPES OF ASSISTANCE TO THEIR OIL CUSTOMERS (FRANCE, U.K., ARAB AID BODIES).
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11. THERE MAY STILL BE SOME EMERGENCY SITUATION IN REQUIRING DIRECT INVOLVEMENT OF NATIONAL AUTHORITIES TO MEET A PROBLEM IN A PARTICULAR COUNTRY. ALL MAJOR GOVERNMENTS WILL WATCH THE SITUATION CAREFULLY, CONSULT WITH ONE ANOTHER REGULARLY, KEEP AS WELL INFORMED AS POSSIBLE, AND FACTOR THE KNOWLEDGE INTO THEIR POLICY FORMULATION. NEVERTHELESS, THERE IS NEITHER A DESIRE NOR A NEED FOR GOVERNMENTS TO TAKE AWAY FROM THE PRIVATE MARKETS THE BASIC ROLE THEY HAVE TRADITIONALLY PLAYED IN MOVING FUNDS ABOUT THE WORLD. END SUGGESTED TALKING POINTS.

WALLICH BELIEVES IT IS DESIRABLE TO AVOID LENDER-OF-LAST-RESORT QUESTION. THE PRESS REPORTS THAT THERE HAD BEEN A BROAD UNDERSTANDING AT THE BIS REGARDING LAST-RESORT LENDING WERE INACCURATE, BUT IT IS DESIRABLE NOT TO DRAW ATTENTION TO THIS FACT.

IF QUESTION ARISES, IT COULD BE NOTED THAT THE FEDERAL RESERVE OF COURSE IS THE LENDER OF LAST RESORT FOR U.S. BRANCHES IN LONDON. AWARE OF THEIR LENDER-OF-LAST-RESORT RESPONSIBILITIES, CENTRAL BANKS ARE CLOSELY WATCHING THE SITUATION AND ARE IN

TOUCH WITH ONE ANOTHER.

IN THIS CONNECTION YOU MAY ALSO FIND USEFUL FOLLOWING QUOTE
FROM WALLICH SPEECH:

BEGIN QUOTE: THE INSTITUTIONS OF THE PRIVATE SECTOR ARE NOT
ALONE INCARRYING A RESPONSIBILITY. IN EVERY MATURE FINANCIAL
SYSTEM, THE CENTRAL BANK TRADITIONALLY HAS ACCEPTED THE ROLE
OF A LENDER OF LAST RESORT. THIS ROLE, OF COURSE, DESCRIBES
A RESPONSIBILITY FOR THE FUNCTIONING OF THE FINANCIAL SYSTEM
AS A WHOLE, NOT FOR THE WELFARE OF PARTICULAR INSTITUTIONS.
MOREOVER, IN ITS ROLE AS LENDER OF LAST RESORT, THE CENTRAL
BANK DEALS WITH PROBLEMS OF LIQUIDITY, NOT OF SOLVENCY.
AND ITS ABILITY TO PROVIDE LIQUIDITY MUST REMAIN CIRCUMSCRIBED
BY THE NEED TO AVOID INFLATIONARY CONSEQUENCES. A CENTRAL
BANK HAS RESPONSIBILITY FOR PRESERVING THE STRENGTH OF THE
CURRENCY, DOMESTICALLY AS WELL AS INTERNATIONALLY. END QUOTE

FOLLOWING IS REQUESTED DESCRIPTION OF CURRENT MONITORING OF
U.S. BRANCHES IN LONDON BY U.S. AUTHORITIES:

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AMERICAN AUTHORITIES ARE TAKING A VARIETY OF STEPS TO MONITOR
THIS SITUATION AND IMPROVE INFORMATION AVAILABLE CONCERNING
DEVELOPMENTS. THE COMPTROLLER OF THE CURRENCY HAS OPENED AN
OFFICE IN LONDON. THE U.S. TREASURY HAS DEVELOPED A REPORT-
ING SYSTEM TO COVER FOREIGN EXCHANGE POSITIONS. EARLY IN
THE YEAR, THE FEDERAL RESERVE REQUESTED BANKS TO SUBMIT MONTHLY
REPORTS TO ENABLE A MONITORING OF CAPITAL FLOWS IN THE WAKE
OF THE TERMINATION OF CAPITAL CONTROLS. ALL THESE MOVES WILL HELP
US TO KNOW BETTER AND SOONER WHAT IS GOING ON AND FACILITATE
OUR SUPERVISION OF U.S. INSTITUTIONS.

THE COMPTROLLER OF THE CURRENCY MAINTAINS A LONDON STAFF OF HIS
BEST QUALIFIED EXAMINERS TO MAKE DIRECT EXAMINATIONS OF
ALL U.K. BRANCHES OF NATIONAL BANKS. INDIRECT EXAMINATIONS
OF ALL FOREIGN BRANCH ACTIVITY OF NATIONAL BANKS ARE MADE
EVERY EIGHT MONTHS THROUGH REPORTS ON CREDIT, FOREIGN EXCHANGE
AND OPERATIONS. THESE REPORTS ARE REQUIRED OF ALL FOREIGN
BRANCHES OF NATIONAL BANKS AND THEY MUST BE ON FILE AT THEIR
DOMESTIC HEAD OFFICES FOR REVIEW BY U.S. EXAMINERS. SOME
100 OTHER EXAMINERS ON A ROTATIONAL BASIS MAKE DIRECT EXAMIN-
ATIONS OF ALL OTHER FOREIGN BRANCHES IN ALL HOST COUNTRIES
NOT OBJECTING TO SUCH EXAMINATIONS.

ON JULY 22, THE COMPTROLLER'S REPRESENTATIVES HELD A MEETING
IN CHICAGO WITH REPRESENTATIVES OF THE THIRTY LARGES U.S.
BANKS, MOST OF WHICH HAVE LONDON BRANCHES. PURPOSE OF THIS
MEETING WAS TO DISCUSS PROCEDURES BY WHICH THE BANKS COULD ASSIST
A BANK WITH A SERIOUS INTERNATIONAL LIQUIDITY PROBLEM.
SPECIFIC MATTERS DISCUSSED INCLUDED THE METHODS BY WHICH THE

BANKS COULD PROMPTLY PURCHASE OR FUND A LARGE VOLUME OF LONDON BASED LOANS. THIS MEETING HAD THE APPROVAL OF THE ANTITRUST DIVISION OF THE DEPARTMENT OF JUSTICE. A BANKERS STEERING COMMITTEE WAS ESTABLISHED TO HANDLED THE DETAILS OF THE PROBLEMS INVOLVED.

COMPTROLLER IS ALSO REVIEWING THE MAY 1974 INTERNAL FOREIGN EXCHANGE REPORTS OF THE 25 LARGEST NATIONAL BANKS. THESE REPORTS INCLUDE THE REPORTS FROM THE LONDON BRANCHES.
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